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DOW THEORY LETTERS

"The Market as Interpreted under the Dow Theory"

RICHARD RUSSELL
P. O. Box 15196
San Diego 15, California

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THE MARKET The 11 point decline from N to O (see chart) served to correct the violent July-August advance (K-N). Letter 154 drew attention to the fact that during the N-O decline (1) volume decreased steadily, (2) Rails held persistently above point M (139.44), thus refusing to confirm the Industrial penetration of M, and (3) odd-lot transactions swung quite heavily to the selling side. For these reasons, it was stated, the expectation was for another attack on the N highs.

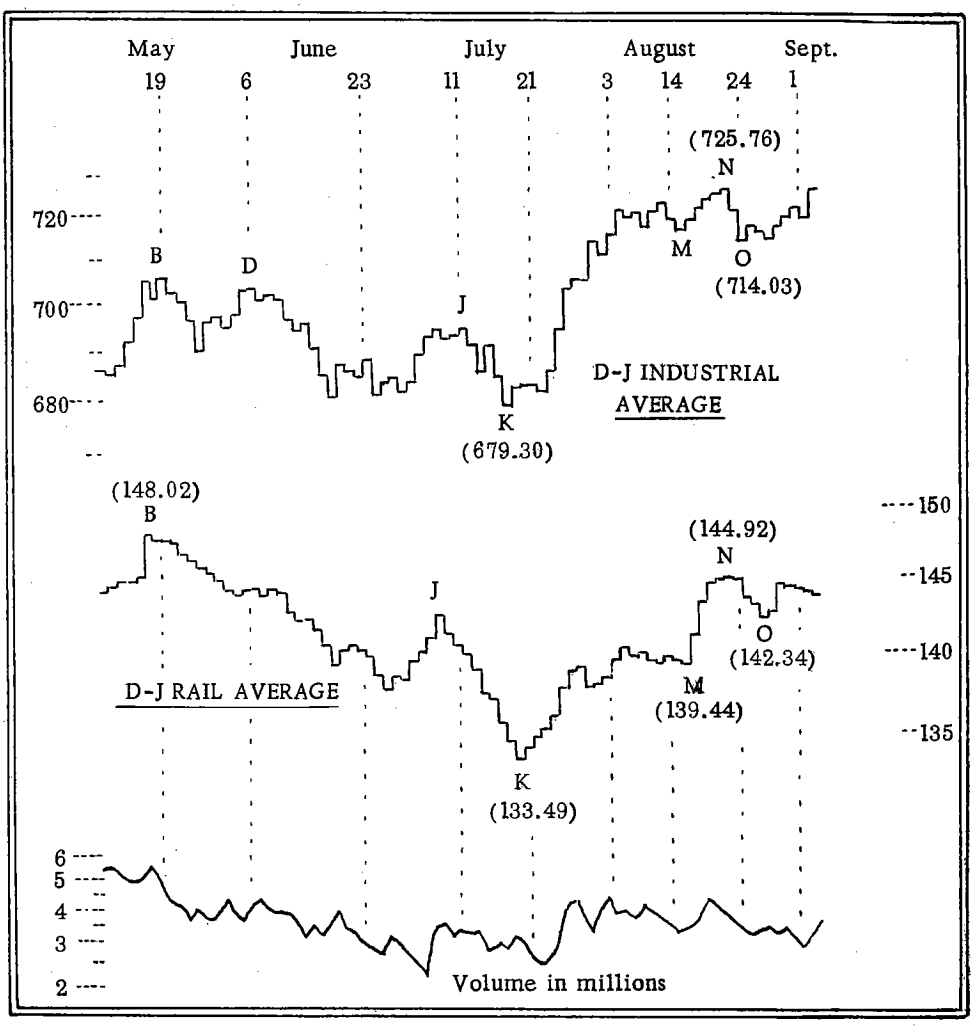
Following Letter 154 , both Averages rallied toward N. On September 6 the Industrial Average rose to a new all-time high of 626.01.

During the N-O decline, Rails (see chart) proved to be the stronger Average in that they refused to follow the Industrial Average below point M. It is therefore somewhat surprising to see Rails hesitate as Industrials rise to a new high.

Prior to the September 6 high, Industrials had fluctuated within a narrow 11.73 point range for 24 consecutive trading days. As of this writing, Rails have held within a 2.58 point range for the past 14 trading days.

A joint penetration of such narrow trading areas ("lines") often has important forecasting implications.

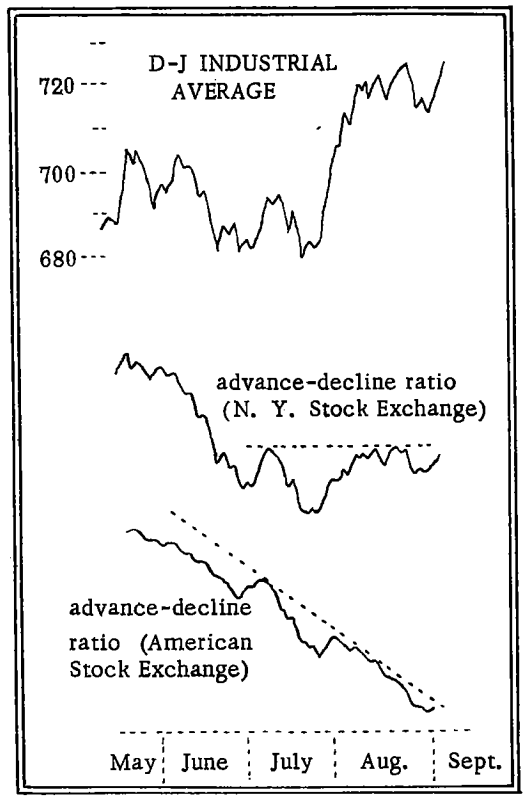
If Rails confirm the Industrial "breakout" by bettering point N (144.92), the advance should gather added momentum. Conversely, a persistent refusal by Rails to better N could be the first hint of impending danger. The danger would be underscored if odd-lot buying increases (odd-lotters have switched to the buying side over the past three days), and if the performance of the advance-decline ratio remains unimpressive.



CONCLUSION: The primary trend or great tidal force of the market remains bullish. The primary trend will be reconfirmed as bullish if Rails can better their high for the year at 150.81 (established March 22). The secondary trend remains up, having been confirmed as bullish when the Rail Average bettered its July peak of 142.48.

NEW YORK and AMERICAN In recent Letters I have directed attention to the sluggish performance of the general market as represented by the advance-decline ration (A-D ratio). The A-D ratio is simply the difference between the total number of stocks that advanced on a given day and the total number that declined, divided by the total number of issues traded that day. If more issues advanced than declined, the daily figure is added to the previous day's figure, if more issues declined than advanced the daily figure is subtracted. In other words, the A-D ratio on the

accompanying chart shows the advancing or declining tendencies of all the stocks listed on the N. Y. Stock Exchange.

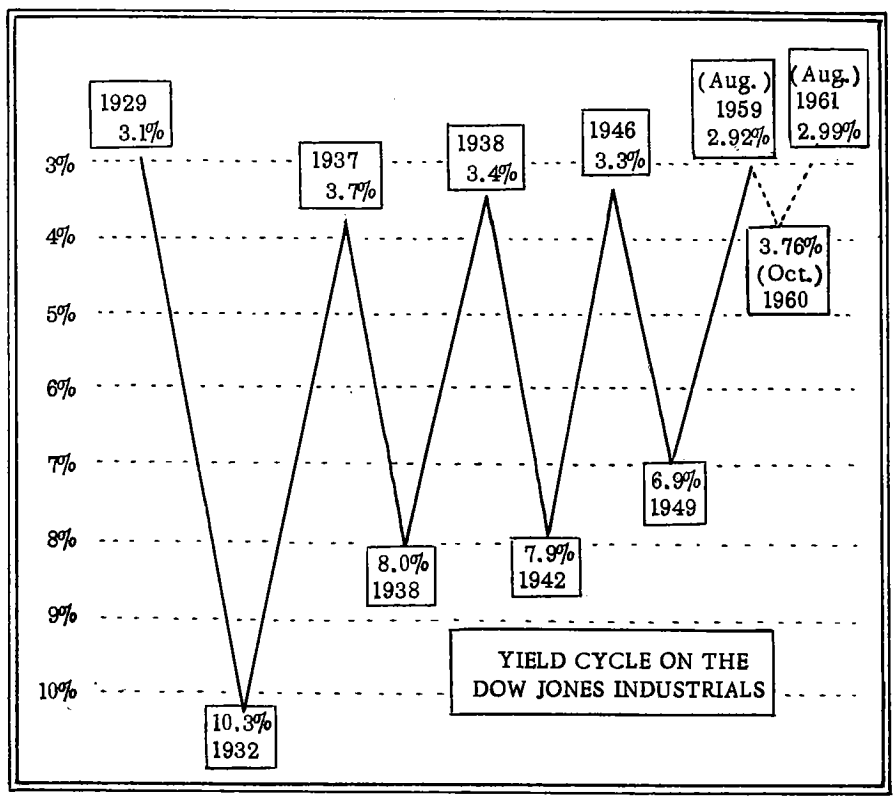


Letters 152 and 153 commented upon the fact that on the recent Industrial rally (K-N) to an all-time high, the A-D ratio was unable to rise appreciably above its July 6 peak (see chart). This means that the Industrial Average has been putting on "on show of its own". Such shows, however, are usually short lived unless the majority of the stocks on the Exchange can follow through to the upside (thus confirming the action of the Industrial Average).

One of the more interesting phenomenons of the current period is the "contrary" performance of the stocks on the American Exchange, and the chart shows the progress of the A-D ratio on the American Exchange since July 1. The picture, then, is as follows: while the D-J Industrial Average was racing to new highs, most of the stocks on the N. Y. Stock Exchange were "marking time", and the majority of stocks on the American Exchange (which tend to be speculative or "crowd" stocks) were sinking lower.

This is a far cry from the great surge of 1958-59, at which time all stocks on both Exchanges were rising en masse. The poor performance of the American Exchange emphasizes a point which I have been harping on for some time--namely, that this is an extremely selective market, and that the "blue-chip" D-J Industrial stocks have been one of the only groups to show average profits for the investor. For this reason, I have repeatedly suggested that readers confine most of their trading purchases to the stronger stocks in the D-J Industrial Average. In the final analysis, little if any money has been made over the last five months by those who held a broad list of stocks on either the New York or American Exchanges.

VALUES For many months I have held the view that this is a trader's market (as opposed to a market of values). Common stocks (in the light of history) are now selling at breath-taking price-earnings ratios, and average yields have been reduced to the point where the debt (bonds) of most corporations provides a greater return than does their equity (common stock). Such conditions occur rarely, and then only during periods of extreme optimism. For this reason I have written that the sole justification for holding common stocks at this time is the hope that "they will go higher". Yet history suggests that the best reasons for holding stocks are (1) they represent real value, or (2) that they provide a yield attractive enough to offset their inferior position to bonds (which are a first claim on the assets of a corporation).



Throughout history stocks have fluctuated in broad swings known as bull or bear markets. At the extremes of these swings yields on common stocks have changed drastically. The accompanying chart shows the yield cycle on the D-J Industrial Average since 1929, and it is readily apparent that the market has now entered the "upper stratosphere" as far as yield (or return on investment) is concerned. Normally, investment buying is executed in the "value zone" as represented by the 6-10% yield area on the chart. Normally, informed selling or distribution is carried on in the area of inflated values as represented by the 3 1/2% (or less) yield area on the chart.

In August, 1959, the average yield on the D-J Industrial Average dropped to 2.92%, the lowest average yield (for a major market peak) in history. Following the August peak,

the market dropped steadily until yields (by October, 1960) has risen to the 3.76% range on average. On the basis of past performance, the odds heavily favored a major bear market and a return to the 6% (or more) yield zone. But the full correction of the 1949-59 advance was not to occur at that time. At the 3.76% yield zone, the market "bottomed out", and a new advance began.

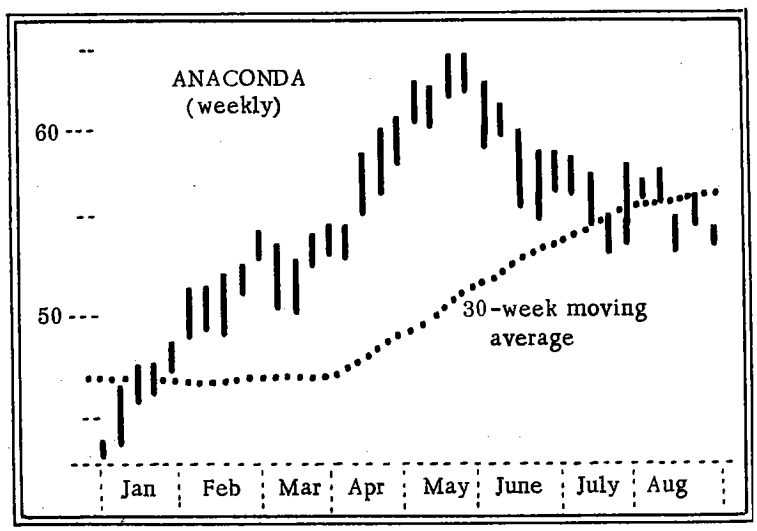
As of the last few weeks, the Industrial Average has returned to the 2.9% yield zone. As seen on the chart, we are now in the area of extreme overvaluation. Based on previous records, stocks have again entered the general area where informed distribution and a major "top" can be expected. Of course, no one can say that the market will not rise to an unprecedented 2.5% or even 2.0% level of average yields. But we do know that we are at the point where stocks must be bought for reasons other than that they represent "values".

It is worth noting that the "hopelessness" of the "value approach" in today's market has brought about one important change. It has caused investors throughout the country to turn to the "technical approach." This writer suggests that readers do not completely cast off one of Charles Dow's favorite aphorisms: "Over any considerable period of time", wrote Dow, "the trend of prices is towards values."

STOCKS Eight of the Seventeen stocks in our "continuous study" group are now under their long-term or 30 week moving average. This is the poorest showing since late July.

American Telephone, as noted in Letter 152, has been barely holding above its moving average (M. A.), which is now 120. It broke a long-term trend line in June and has been losing shorts steadily. T is neutral, and will be definitely bearish if it closes below 114.

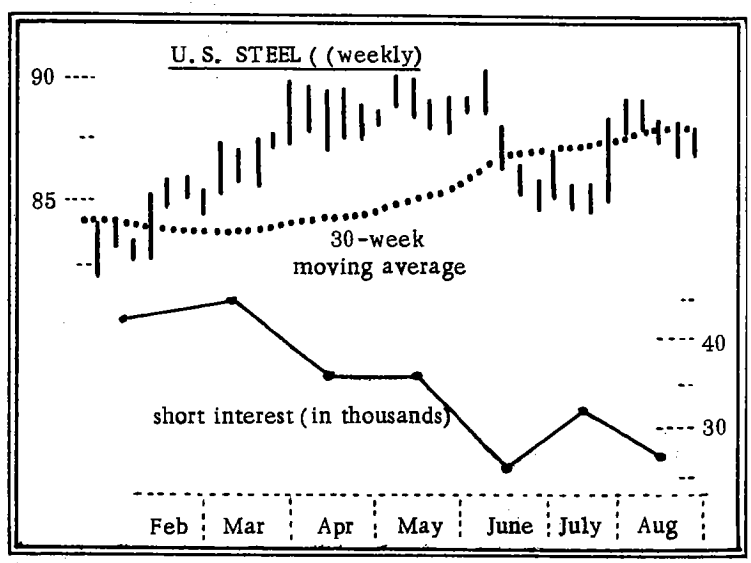
Anaconda (see chart) is under its M. A. of 56 3/8. Critical support for A is at 53, and the stock must be listed as trendless at this time.



International Harvestor, hurt by news of the farm drought, broke temporarily below its M. A. (now 52), then climbed above it again. Critical support is in the 49 area, below which it should be sold.

Sears Roebuck was favorably commented upon in recent Letters. The stock still looks very strong and has been holding well above its M. A. of 63 3/4.

U. S. Steel (see chart) broke below its M. A. (now 85 5/8) in June. X dropped to 79, then reversed and rose above its M. A. to 88 1/2 (August). More recently, X has again fallen below its M. A., but so far there has been no real conviction in the selling. If X approaches the 79-80 area and "holds", I would consider it a candidate for speculative purchases. (The fact that the short position in X has dropped to the low area for the last four years is not encouraging from the technical standpoint).



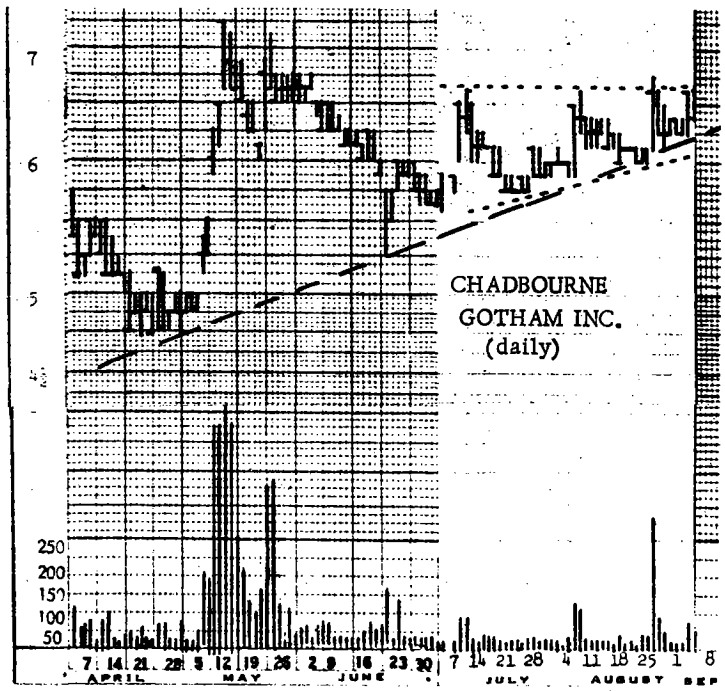
Chadbourne Gotham (page 4) is an interesting low-priced speculation at this time. Note on the (daily) chart the "breakaway gaps" of early May. Such action implies great force, and the huge volume at that time testifies to the strength of the upside action. In mid-May the stock consolidated, and the downward correction came in June. Since then the stock seems to have been under accumulation, and a bullish ascending triangle has been formed (dotted lines). Note too, that the triangle has formed above the major ascending

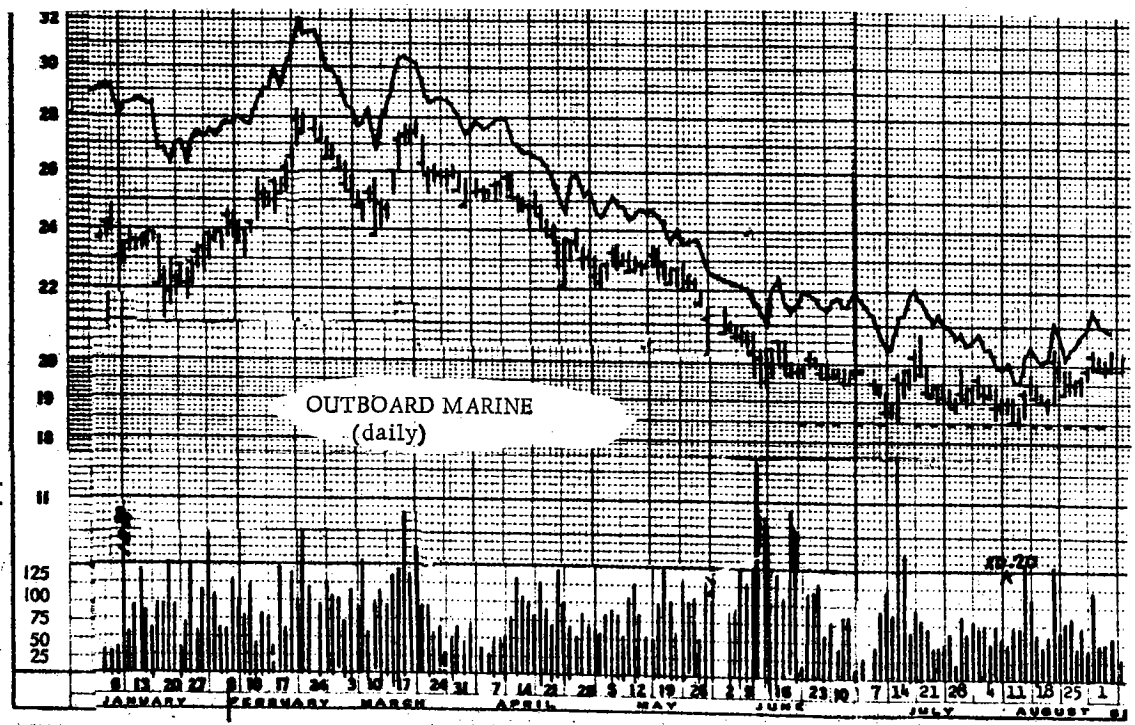
trendline (heavy dashed line). CGI would seem to be a buy "at the market". A rise above the year's high of 7 1/4 could send the stock sharply higher.

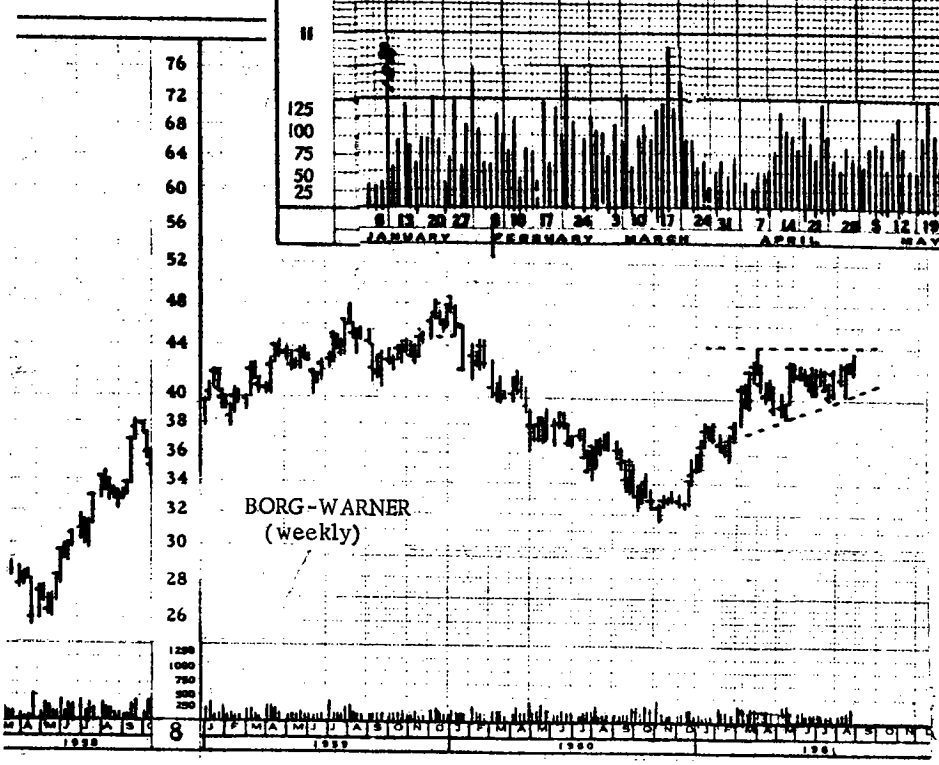
Outboard marine has been a "dog" since mid-1959. At that time the stock sold as high as 39 3/8. Since then it has been in a steady downtrend, striking a low of 18 3/8 this year. Note the "double bottom" in July and August and the general sluggishness of the price movements since late May. Such action, following a long decline, often denotes accumulation. OM would seem to be a limited risk in this area, while a rise above 21 could send it a good deal higher. (Solid black line on chart indicates relative strength of OM as compared to the general market).

The weekly chart of Borg-Warner shows an impressive ascending triangle with a top at 44. The rationale of such formations is as follows: accumulation takes place within the triangle with buyers slowly absorbing all offerings at 44 or below. On each decline less stock is offered -- thus buyers are forced to pay increasingly higher prices (this gives rise to the ascending bases). Finally all the stock at 44 or below is absorbed and the stock "breaks" above the triangle top. Borg-Warner should be a buy at the market.

Charts on this page courtesy of Traders Research, P. O. Box 6185, Lambert Airport, Mo.







(This Letter written Wednesday, Sept. 7, 10 P. M.)